NO.

IN THE

Supreme Court of the United States

OCTOBER TERM 1978

78-375

GENEVIEVE M. HADDAD
Petitioner,

VS.

THE CROSBY CORPORATION, ET AL.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Genevieve M. Haddad hereby respectfully petitions for the issuance of a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered in the above-entitled case on June 6, 1978.

OPINIONS BELOW

The first opinion of the District Court (Appendix A, *infra*) is reported as *In re Mutual Fund Sales Antitrust Litigation,* 374 F.Supp. 95 (D.D.C. 1973). The first opinion of the Court of Appeals (Appendix B, *infra*) is reported as *Haddad* v. *The Crosby Corporation,* 533 F.2d 1247 (D.C.Cir. 1976). The

opinion of the District Court on remand (Appendix C, *infra*) was not reported. The second opinion of the Court of Appeals (Appendix D, *infra*) was not reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 6, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTION PRESENTED

This Court in *United States* v. *National Association of Securities Dealers, Inc.*, 422 U.S. 694 (1975) found an implied exemption to the antitrust laws in Section 22(f) of the Investment Company Act of 1940, 15 U.S.C. §80a-22(f), for intrafund restraints on competitive conduct in the chain of distribution. Can that opinion form the predicate for exempting restraints upon interfund competitive conduct, presumably under the Maloney Act or some form of interaction between the Maloney Act and the Investment Company Act?

STATUTES INVOLVED

Sections 1, 2 and 3 of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. §§1, 2 and 3, provide in pertinent part:

> Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . .
>
> Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony.

> Sec. 3. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is declared illegal.

Section 1(b)(8) of the Maloney Act, 52 Stat. 1070, as amended, 15 U.S.C. §78o-3(b)(8), provides in pertinent part:

> Sec. 1(b)(8). An applicant association shall not be registered as a national securities association unless it appears to the Commission that
>
> * * *
>
> (8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

Sections 22(d) and 22(f) of the Investment Company Act, 54 Stat. 789, as amended, 15 U.S.C. §§80a-22(d) and 80a-22(f), provide in pertinent part:

> Sec. 22(d). No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. . . .

> Sec. 22(f). No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

STATEMENT OF THE CASE

Load mutual funds are characterized by contractually imposed vertical restraints on pricing and by the total suppression of secondary dealer and secondary brokerage markets through industry wide utilization of identical agreements.

The complaint herein charged that both were *per se* violations of the antitrust laws.[1] Some months later, the United States Department of Justice filed a somewhat similar series of

[1] *Haddad* v. *National Association of Securities Dealers, Inc.*, No. 2454-72, D.D.C., complaint filed December 8, 1972.

charges divided into one horizontal and eight vertical counts.[2] Both cases—together with others filed consequent upon the Government action[3]—were dismissed on the pleadings by the District Court on the theory that the Investment Company Act of 1940,[4] had created an implied exemption to the antitrust laws in favor of the Securities and Exchange Commission.[5] The Government case was appealed directly to this Court, where, by a process of attrition, the "horizontal" count had been reduced, finally, in the words of defense counsel, to a "non-case."[6] In *United States* v. *National Association of Securities Dealers, Inc.*, 422 U.S. 694 (1975), this Court sustained the District Court's finding of an implied exemption to the antitrust laws in Section 22(f),[7] of the Investment Company Act permitting funds and their underwriters to impose restraints on dealers and brokers through contract. This Court expressly found that there were no horizontal restraints charged in the Government case as it was ultimately structured and reversed the District Court's finding of horizontal immunity under Section 22(d), 15 U.S.C. §80a-22(d).

The Court of Appeals for the District of Columbia Circuit[8] then remanded this case to the District Court to determine whether there were any non-price horizontal elements left in this case, since any horizontal price elements would appear to

[2] *United States* v. *National Association of Securities Dealers, Inc.*, No. 338-73, D.D.C., complaint filed February 21, 1973.

[3] In addition to these suits, approximately fifty other similar suits were filed in federal district courts across the country and were transferred to the lower Court herein by the Judicial Panel on Multidistrict Litigation.

[4] 15 U.S.C. §80a-1, *et seq.*

[5] *In re Mutual Fund Sales Antitrust Litigation*, 374 F.Supp. 95 (D.D.C. 1973) (Haddad I).

[6] Record at 50, *United States* v. *National Association of Securities Dealers, Inc.*, 422 U.S. 694 (1975).

[7] 15 U.S.C. §80a-22(f).

[8] *Haddad* v. *The Crosby Corporation*, 533 F.2d 1247 (D.C. Cir. 1976) (Haddad II).

be only peripheral to the vertical pricing arrangements approved by this Court in the companion Government case.[9] This peculiar characterization of inter-product competition as peripheral to intra-product competition, of course, doomed our case. As we pointed out below, *all* restraints on competition impact ultimately on price or they wouldn't occur. Only if the Circuit Court's opinion were construed as barring "price-*fixing*" (which we did not charge with respect to our horizontal allegations), could *any* antitrust charge survive this limitation. We so argued in the District Court which found, quite properly, that we had not charged any conduct which did not impact on price. That Court thereupon again dismissed the complaint[10] and was sustained therein by the Circuit, per curiam, on its opinion.[11]

REASON FOR GRANTING THE WRIT

A secondary brokerage or secondary dealer market could not be suppressed by means of the vertical understandings between an underwriter and those in his chain of distribution which this Court found acceptable.[12] For then any broker could

[9] The Court of Appeals in *Haddad II* stated as follows:

> We recognize that a degree of inter-fund restraint is implicit in the intra-fund combinations which the Supreme Court found to be immunized. The fixing of the price at which each fund's shares will trade largely eliminates the price component of inter-fund competition. However, it is also clear that agreements are possible which are explicitly inter-fund in nature, which impair competition arising from factors other than price. Fund managers, for example, might agree to the types of securities each would purchase, and thus position their products in a way to minimize competition between them.

535 F.2d at 1250.

[10] *Haddad* v. *The Crosby Corporation*, No. 2454-72 (D.D.C. June 30, 1977) (Haddad III).

[11] *Haddad* v. *The Crosby Corporation*, No. 77-1786 (D.C. Cir. June 6, 1978) (Haddad IV).

[12] For an overview of the mutual fund industry, see *United States* v. *Cartwright*, 411 U.S. 546 (1973).

trade all other fund shares in such secondary markets. The suppression of these markets has worked only because common schemes have been introduced in the bulk of the industry through a concert of action between its members at every level of distribution.

Historically, the Congress has, at times, permitted vertical restraints on competition from a common understanding that interproduct competition (here suppressed) would support the public interest partially curtailed by intra-product restraints sporadically thought useful. We are to infer an implied exemption to the antitrust laws in the governing legislation—the Maloney Act—which itself contains an express prohibition against any deviation from those antitrust laws.[13] Surely we make mock of the supposed primacy of those antitrust standards by such outrageous tinkering.

With respect to "load" open end mutual funds—the product market in this case—there have been imposed significant restraints on a "free and open" market for the trading of such securities.[14] The public offering price is fixed by the issuer

[13] The Maloney Act of 1938, 15 U.S.C. §78o-3(b)(8), provides in pertinent part:

> (b) An applicant association shall not be registered as a national securities association unless it appears to the [Securities Exchange] Commission that
>
> * * *
>
> (8) the rules of the association are designed to ... remove impediments to and perfect the mechanism of a free and open market; and are not designed to . . . fix minimum profits . . . or fix minimum rates of commissions, allowances, discounts, or other charges.

[14] There are more than 500 mutual funds in the United States with total net assets in excess of $55 billion. Of these approximately 420 are "load" mutual funds which account for more than 90% of industry assets and have more than 8 million shareholder accounts.

and both the secondary brokerage and the secondary dealer markets have been almost entirely suppressed.

This suppression has arisen through two vehicles. A particular fund enters into contracts through its primary distribution chain whose members agree not to act as brokers or as dealers in a secondary brokerage or dealer market. Since such a marketing strategy would be disasterous for a single fund, the bulk of the various members of the industry, through concert, have agreed upon uniform contracts containing identical restraints on alienation. Thus the two secondary markets have virtually disappeared. This is, of course, an economically sound strategy for the industry. The brokers receive a triple commission and the underwriter receives 1½ to 2% of the selling price on *every* load fund share sold rather than on 20% or so which would obtain if a secondary market functioned. The issuer, who earns his fees based on the size of his fund, gets an enthusiastic selling force. The retail customer, on the other hand, pays three times the commissions obtaining with respect to other securities and receives the advice of a fiduciary—his broker—which is strongly biased by force of the disproportionate earnings he receives on this type of security alone.

The typical load fund today pays a seller net asset value and charges a buyer net asset value plus 9.3%. A secondary brokerage market could secure a seller a higher price—say net asset value plus 3% and a buyer a lower price say net asset value plus 6%. A secondary dealer market would have to charge net asset value plus 9.3% but could *pay* net asset value plus, say 5%, and attract customers by reason of the higher net payout.

The extent to which these otherwise *per se* violations of the antitrust laws are exempted therefrom either expressly or by necessary implication in order to make some particular statutory scheme work has been the subject of this and the similar government case. This "necessary implication" test is the standard used by this Court in *Silver* v. *New York Stock*

Exchange.[15] Both the majority and the minority in the companion government case agreed that it was the test to be applied here.[16]

It has been generally agreed that Section 22(d) of the Investment Company Act of 1940 imposed a Retail Price Maintenance Scheme on the primary distribution chain in the sale of open end mutual funds which went even further and bound *any* dealer from *selling* at other than the price fixed by the issuer even though he may have acquired his shares from outside the primary distribution system. This statutory prohibition was designed to stop non-contractually bound dealers from impacting negatively on the primary distribution system. The court below originally ruled that this restriction also effectively barred a secondary brokerage market, but this Court, in the companion government case specifically rejected this conclusion.[17]

Section 22(f) of the Investment Company Act of 1940, in terms, permits the SEC to establish rules governing restraints imposed by a fund on alienability of its securities and requires the publication of such restraints in registration statements.

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[15] 373 U.S. 341 (1968).

[16] 422 U.S. at 734 and 739-740.

[17] With respect to Section 22(d), this Court in *United States* v. *National Association of Securities Dealers, Inc., supra,* held as follows:

> We therefore hold that the price maintenance mandate of §22(d) cannot be stretched beyond its literal terms to encompass transactions by broker-dealers acting as statutory "brokers." Congress defined the limitations for the mandatory price maintenance of the Investment Company Act. We are not only bound by those limitations but we are bound to construe them strictly, since resale price maintenance is a privilege restrictive of a of a free economy. United States v. McKesson & Robbins, 351 US 305, 316, 100 L Ed 1209, 76 S Ct 937 (1956). Accordingly, we hold that the District Court erred in relying on §22(d) in determining that the activities here questioned are immune from antitrust liability.

422 U.S. at 720.

Contemporaneous SEC studies suggest that the purpose of this section was to make sure that the public was fully advised of what such restrictions were, but a majority of this Court in the companion government case ruled that this language sanctioned the restraints imposed by the funds unless and until abrogated by SEC rule. Because some of the restraints imposed by the funds unduly restricted the right of brokers and dealers in the securities of those funds to sell to or through nonconforming persons, the majority found a necessarily implied exemption to the antitrust laws in such vertical restraints.

Since the government case was limited to the vertical restraints found insulated by the majority's interpretation of Section 22(f) of the Investment Company Act, that case was dismissed.

Since the thrust of the complaint in this case was against the suppression of a form or forms of competition—secondary brokerage and secondary dealer trading—the complaint was not couched in terms of vertical and/or horizontal counts. It spoke rather to the concert of the entire industry in restraining competition *throughout the industry.* Can the Investment Company Act, either alone, or in conjunction with some other legislative mandate be construed as creating some implied immunization to anti-competitive industry-wide conduct?

As is apparent on their faces, Sections 22(d) and 22(f) are parts of a Retail Price Maintenance Scheme, that is, one imposed by the producer on his distributional chain. Both speak directly and solely to protection of the Primary Distribution System. Now Retail Price Maintenance did not begin with the Investment Company Act of 1940. Strong efforts were made as early as 1929 to enact a Federal Retail Price Maintenance Law. Starting in 1931 with California, some 42 states adopted Retail Price Maintenance Laws before the 75th Congress finally enacted the Miller-Tydings Act,[18] in 1937 giving federal sanction to such programs. But this depression-born

[18] 15 U.S.C. §1 (Miller-Tydings Act repealed in 1975).

abandonment of competition as our primary pricing mechanism was carefully cabined and confined by a cautious Congress (which we know has now largely abandoned the experiment). Retail Price Maintenance was permitted only with respect to products "in free and open competition" with the products of another manufacturer. The House Report carefully noted the problem:

> [I]t is contended that price maintenance legislation tends unduly to enhance the price of goods to the consumer. To this argument it is answered that the free play of competition between products of different manufacturers of the same general class will prevent such a result.[19]

But if the Investment Company Act only protected intra-fund, vertical conduct from the antitrust laws, what shields conduct designed to suppress competition between funds? Since most underwriters, dealers and brokers are members of the National Association of Security Dealers, may they look to that group's enabling legislation, the Maloney Act? That argument would appear to have been answered dispositively by the precise terms of the statute itself. The Maloney Act of 1938 provides in relevant part as follows:

> (b) An applicant association shall not be registered as a national securities association unless it appears to the [Securities Exchange] Commission that
>
> * * *
>
> (8) the rules of the association are designed to . . . remove impediments to and perfect the mechanism of a free and open market . . . .[20]

[19] H.R. REP. No. 382, 75th Cong., 1st Sess. (1937).
[20] 15 U.S.C. §78o-3(b).

As we have seen, two years later, the Congress modified this injunction with respect to Retail Price Maintenance, intra-fund. But it would be absurd to argue that the Maloney Act created an implied exemption to the antitrust laws because such exemption was necessary in order to effectuate the statutory scheme—a statutory scheme which mandated adherence to the antitrust standards in so many words.

In *N.A.S.D.*, Mr. Justice Powell concluded with respect to the limited horizontal charges in the government's complaint that:

> [A]ppellant does not contend that appellees' activities have had the purpose or effect of restraining competition among the funds. Instead, appellant urges in Count I that appellees' alleged conspiracy was designed to enourage the suppression of *intra-fund* secondary marketing activities.[21]

The NASD could, in support of the vertical restraints on alienability and Retail Price Maintenance sanctioned by the Investment Company Act of 1940, agree among its members—for example, to discipline members who violate such intra-fund restraints or to police such intra-fund activity through some surveillance and reporting system. What the industry cannot do, however, is to participate in plans, programs and understandings whereby—*i.e.*, the different funds would adopt uniform or similar rules respecting alienability or price with the purpose or effect of assuring that secondary dealer or brokerage markets would not arise to place competitive pressures on the various primary pricing systems of the individual funds.

Not for the purpose of proving any "facts" with respect to this case, but solely to show one way in which inter-fund activity could, in our view, still run afoul of the antitrust laws, we should like to quote from one of the few documents we have

[21] 422 U.S. at 733 (emphasis added).

been able to obtain thus far in this case. The Investment Company Committee of the NASD was concerned with the secondary dealer market in fund shares and reported to the NASD Board, in pertinent part, as follows:

> [A]s a matter of policy [we] will use [our] best efforts to encourage underwriters to amend their selling group agreements so that sales to dealers are limited to purchases for investment or to fill orders from members of the public, and to enforce these agreements by cancelling contracts with firms that may not live up to the undertakings of such agreements. . . . [the Committee] will. . . continue to encourage other underwriters to amend and enforce their selling group agreements as outlined above. It is suggested that the Executive Director send a letter to underwriters and distributors of investment company shares suggesting that they make any necessary revisions of their selling group agreements to make it clear that sales may be made only for the purpose of filling orders from members of the public or for investment and suggesting the importance of self-enforcement of selling group agreements by underwriters.[22]

Such a letter was sent.

To urge that members of an industry adopt similar or identical vertical restraints is to limit, restrain or to dissipate competition *among* competitors. But in approving Retail Price Maintenance—a concept it has since largely abandoned as counter-productive[23]—the Congress was very careful to guard

[22] Document attached as Exhibit No. 17 to Affidavit of Daniel R. Hunter, Esquire, United States Department of Justice Antitrust Division, dated July 5, 1973, and filed with the United States District Court for the District of Columbia in the *United States* v. *N.A.S.D.* litigation on July 6, 1973.

[23] The Miller-Tydings Fair Trade Act was repealed pursuant to Pub.L. 94-145 which was passed by the Congress in 1975.

the public through the vehicle of inter-product competition—competition which the conduct here complained of has the precise purpose or effect to pinch off.

Similarly, the destruction of the secondary *brokerage* market is a direct result of the imposition by the industry of uniform sales agreements. A 1974 Staff Study of the SEC concluded on this point:

> By its terms, Section 22(d) does not apply to brokered transactions. Nevertheless, no secondary market in mutual funds has developed because form sales agreements between underwriters and broker-dealers effectively prohibit such a secondary market.[24]
>
> This precise conduct is charged in our complaint. See, e.g.; the following paragraphs from the Complaint in *Haddad* v. *The Crosby Corporation et al.*:
>
> 42. The unlawful conduct, acts and practices of defendants and coconspirators included, among other things, continuing agreements, understandings and concerted acts having the common design, purpose, objective and effect to:
>
> (a) Prevent the defendant broker-dealers from acting as agents or brokers for the members of the Investor Class . . . .
>
> (c) Prevent any defendant, including defendant broker-dealers, from "crossing" trades by investors . . . as in this set by matching orders with sales . . . .

[24] Securities Exchange Commission Report of the Division of Investment Management Regulation, Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940, p. 109 (August 1974).

> 43. Defendants knowingly and willfully did those things which, as hereinabove alleged, they combined and conspired to do, and each defendant accepted, adhered to and participated in the common design and scheme knowing that concerted action was contemplated and invited, and that such cooperation was essential to the success of the scheme.

This language, these charges, are incompatible with sole or even primary intra-fund conduct.

It would seem hornbook that the vertical restraints permitted under the Investment Company Act must be narrowly construed and not expanded to protect inter-fund anticompetitive conduct. Such a rule is predicated on the precise language of this Court in another Retail Price Maintenance case, *United States* v. *McKesson & Robbins,*[25] wherein it was stated that:

> Congress has marked the limitations beyond which price fixing cannot go. We are not only bound by those limitations but we are bound to construe them strictly, since resale price maintenance is a privilege restrictive of a *free* economy. (Citation omitted). . . .[26]
>
> Sufficient protection to the public interest was deemed to be afforded by the competition among different brands . . . . In short, the very purpose of the [Miller-Tydings and Maguire] Acts is to permit a manufacturer to set the retail price for his own products while preserving competition between . . . manufacturers.[27]

We submit, respectfully, but as forcefully as we can, that Retail Price Maintenance under the Investment Company Act is entitled to no broader parameters than obtained while a general Retail Price Maintenance Scheme was in force.

[25] 351 U.S. 305 (1956).

[26] *Id.* at 316.

[27] *Id.* at 317 (Harlan, J., dissenting).

CONCLUSION

For the foregoing reasons, Haddad's petition for a writ of certiorari should be granted.

Respectfully submitted,

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INDEX TO APPENDIX

United States District Court

FOR THE DISTRICT OF COLUMBIA

In re MUTUAL FUND SALES ANTITRUST LITIGATION.

Civ. A. No. Misc. 103-73

Genevieve M. HADDAD, Plaintiff,

v.

The CROSBY CORPORATION et al.,

Defendants.*

Civ. A. No. 2454-72.

UNITED STATES of America,
Plaintiff,

v.

The NATIONAL ASSOCIATION OF SECURITIES
DEALERS, INC., et al.,
Defendants.**

Civ. A. No. 338-73.

Authur GROSS, Joseph Lerman, and Rose Lerman, on behalf of themselves and all other individual mutual funds shareholders similarly situated, Plaintiffs,

v.

The NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., et al., Defendants.***

Civ. A. No. 426-73.

United States District Court, District of Columbia.

Dec. 14, 1973.

Daniel R. Hunter, Dept. of Justice, Carl W. Schwarz, Charles Jay Pilzer, Washington, D.C., David Berger, Philadelphia, Pa., for plaintiffs.

Daniel P. Levitt, (Liaison Counsel) Paul, Weiss, Goldberg, Rifkind, Wharton & Garrison, Lloyd J. Derrickson, Washington, D.C., for defendants.

MEMORANDUM OPINION

CORCORAN, DISTRICT JUDGE.

I

THE NATURE OF THE CASE

The above-captioned lawsuits are civil actions alleging violations of the federal antitrust laws in connection with the distribution of securities of open-end management investment companies ("mutual funds").[1] The operations of such companies are governed generally by the Investment Company Act of 1940[2] (the 1940 Act).

In Civil Action No. 2454-72, plaintiff Haddad purports to sue on behalf of a class and subclass of mutual fund investors. Haddad alleges violations of the antitrust laws [Sherman Act, Sections 1-3, 15 U.S.C. §§ 1-3] and the securities laws [Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. § 78j (b); Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1972)]. The antitrust claim is that the various defendants, including underwriters of and dealers in mutual fund shares and unnamed co-conspirators have agreed, combined and conspired to inhibit, or to refuse to participate in, transactions as agents or brokers in mutual fund shares at prices below the applicable public offering prices established in the prospectuses of such mutual funds and have placed unreasonable restraints upon the transferability of such shares. In essence, the securities claim is that there is a failure to disclose the alleged antitrust violations and that such failure constitutes an independent violation of the securities laws. Haddad alleges damages to her and her

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[1] By definition an open-end management investment company is any issuer which (1) "is or holds itself out as being primarily . . . in the business of investing, reinvesting, or trading in securities" (15 U.S.C. § 80a-3); (2) is not a face-amount certificate company or a unit investment trust (15 U.S.C. § 80a-4); and (3) is "offering for sale or has outstanding any redeemable security of which it is the issuer" (15 U.S.C. § 80a-5).

[2] 15 U.S.C. § 80a-1 et seq. (1970).

purported class of undetermined millions of dollars. Haddad's antitrust claim requests treble damages and injunctive relief. The securities claim requests actual damages, punitive damages, and injunctive relief.

Civil Action No. 338-73 is brought by the Antitrust Division of the U.S. Department of Justice. The complaint alleges violations of Section 1 of the Sherman Act, 15 U.S.C. § 1. The gist of the complaint is that defendants National Association of Securities Dealers (NASD)[3] funds and dealers have participated in agreements, combinations, and conspiracies, the effect of which has been to inhibit a "market" for "brokerage transactions" and thereby to suppress the growth of a "secondary market in mutual fund securities," and to cause the public to pay artificial and non-competitive sales loads for mutual fund shares. The government complaint seeks only prospective, injunctive relief.

Civil Action No. 426-73, the Gross case, is another private antitrust suit and purported class action which substantially duplicates the government allegations in No. 338-73. This action seeks injunctive relief and treble damages for injury to the purported plaintiff class over an indeterminate past period.[4]

[3] The NASD, incorporated in Delaware on July 18, 1939, became registered under the Maloney Act, § 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78*o*-3, on August 7, 1939. National Association of Securities Dealers, Inc., 5 S.E.C. 627 (1939). It is the only association ever to have applied for or been granted registration under the Maloney Act. Its membership is comprised of some 4400 broker-dealers and principal underwriters.

[4] Since the filing of the above-captioned actions, some fifty private suits, purporting to be class actions under Fed.R.Civ.P. 23, have been filed in various United States District Courts around the country. These cases have been transferred to this district by the Judicial Panel on Multidistrict Litigation, and are collectively cited as: In Re Mutual Fund Sales Antitrust Litigation, Civil Action No. Misc. 103-73. Pre-trial discovery and other activity in all cases (including the instant cases) has been stayed pending disposition of the motions to dismiss under consideration here.

The Court has also reserved judgment in all alleged class suits on the question of whether the actions may be maintained as class actions under Fed.R.Civ.P. 23.

The individual defendants in each case are principal underwriters[5] or broker-dealers[6] in mutual fund shares.[7] Additionally the NASD is named as a defendant in all three cases. In each case the defendants have moved to dismiss the complaints, pursuant to Fed.R. Civ. P. 12(b) on the grounds:

(a) That as a matter of law, Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(d), establishes a system of fixed, retail price maintenance in the distribution of investment company securities which is totally inconsistent with antitrust concepts and which accordingly creates, as Congress clearly intended, an exemption and immunity from antitrust liability for the defendant dealers' conduct in maintaining the fixed, public offering price of such securities;

(b) That as a matter of law, Section 22(f) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(f), sanctions contractual restrictions on the transferability or

[5] A principal underwriter is defined by the 1940 Act as

> any underwriter who as principal purchases from (an open-end investment) company, or pursuant to contract has the right . . . from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company

[6] A broker is defined by the 1940 Act as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." 15 U.S.C. § 80a-2(a)(6). A dealer is defined as "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U.S.C. § 80a-2(a)(11).

[7] The identities of all the parties in each of the above-captioned cases are reflected in the accompanying Orders.

negotiability of investment company securities, subject to supervision of the Securities and Exchange Commission (SEC), which restrictions are totally inconsistent with antitrust concepts and which restrictions, therefore, as incorporated in the defendant dealers' publicly-filed investment company sales agreements, are exempt and immune from antitrust liability; and

(c) That by the Investment Company Act of 1940, Congress subjected the acts and practices of the defendant dealers in the distribution of investment company securities to continuous and pervasive regulation by the SEC as well as NASD acting under the SEC's supervision; and, accordingly, the SEC has exclusive jurisdiction to regulate those acts and practices, and such acts and practices are exempt and immune from the claims herein alleged as violations of the Federal antitrust laws.

The motions were consolidated for argument.[8]

II

THE REGULATION OF MUTUAL FUNDS

The dispute can only be determined ultimately by an analysis of the several subsections of Section 22 of the 1940 Act and an antiturst exemption purportedly given by Section 15A(n) of the Securities and Exchange Act of 1934 (the Maloney Act [15 U.S.C. § 78o-3(n)]. Before reaching that point, however, it would seem appropriate to view the overall regulatory scheme imposed by Congress on investment companies through the 1940 Act.

[8] In opposition to the motions to dismiss all the plaintiffs also rely on the proposition that a complaint should not be dismissed for failure to state a claim unless it appears beyond a doubt that plaintiffs are unable to prove any set of facts which would entitle them to relief. Neither the defendants nor this Court have any argument with that general proposition, but, as the issues are drawn here for purposes of these motions to dismiss, they are strictly legal ones as to which the facts as alleged in the complaints or otherwise are not relevant.

It became apparent to the Congress in 1935 that the disclosure and antifraud provisions of the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act) were not adequate for the regulation of investment companies. Accordingly, it directed the SEC to make a comprehensive study of the investment company industry with a view to proposing corrective legislation. The SEC did so[9] producing a draft "Investment Trust Bill" which was the subject of hearings conducted by a Senate subcommittee.[10] Representatives of the investment company industry were invited to participate in the hearings. Ultimately a compromise bill emerged which finally became law as the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq.[11].

The 1940 Act brought many investment companies within the disclosure requirements of the federal securities laws for the first time. It tightened up those requirements and tailored them to prohibit certain undesirable practices in the investment company industry. Presently, pursuant to the 1940 Act investment companies must register themselves (§§ 7 and 8) and their shares [§ 24(a)] with the SEC, update periodically their filings with quarterly and annual reports [§§ 30(a)-(c)], and submit prospectuses and sales literature to the SEC [§ 24(b)]. Companies must issue to their shareholders, at least semi-annually, financial reports containing specific types of information [§ 30(d)].

[9] Report of the SEC, Investment Trusts and Investment Companies, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Companies, H.R.Doc. No.279, 76th Cong., 1st Sess. (1939) (hereinafter cited as Investment Trust Study of 1940).

[10] Hearings on S. 3580 Before a Subcomm. of Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940) (hereinafter cited as 1940 Senate Hearings).

[11] That Act included § 22(d), one of the sections in controversy in this case, discussed *infra*. Section 22(d) prohibited sales of investment company shares to the public at any price other than the fixed public offering price.

The 1940 Act also imposes detailed restrictions upon investment company structure, conduct, financial policies, and dealings with and by affiliates.[12]

[12] The Act delimits permissible methods for selecting directors of investment companies (and trustees in the case of investment trusts) (§ 16), sets out qualifications for securities custodians [§ 17(i)] and methods of safekeeping securities [§ 17(g)], and prohibits indemnification for official conduct [§§ 17(h) and (i)]. Certain persons guilty of prior malfeasance are barred altogether from affiliating with investment companies, advisers, custodians, and principal underwriters (§ 9). Others who commit misconduct or abuse their positions of trust can be enjoined (§ 36). Misappropriation of company funds is made a federal crime (§ 37).

The Act also sets out minimum capitalization requirements for the companies (§§ 14 and 18). It requires a majority shareholder vote for changes in a company's open-end or closed-end nature, its diversification, its capacity to borrow money, issue senior securities, underwrite others' securities, purchase and sell real estate and commodities, or make loans, its investment policies and its fundamental business (§ 13). Certain dividend distributions are barred unless timely disclosed to the shareholders (§ 19). Investment companies are barred from participating in certain types of securities transactions [§ 12(a)] and from making certain loans (§ 21). Some proxy solicitations are barred [§ 20(a)] and some exchanges need prior SEC approval (§ 11). Reorganization plans must be submitted to the SEC, which can render a negative advisory report and seek an injunction with respect to such reorganizations (§ 25). Voting trusts and cross or circular ownership patterns are barred (§ 35). Accountants must meet certain criteria, be selected in a particular fashion, and perform certain functions (§ 32). The regulated companies must keep and refrain from destroying certain books and records (§§ 31 and 34). Unit investment trusts (§ 26) and face amount certificate companies (§§ 28-30) are given special regulatory treatment.

The Act curtails the pyramiding of mutual funds [§§ 12(d)-(g)]. Unless it is itself the principal underwriter, no investment company may acquire shares of another company whose principal underwriter is related to the first company [§ 10(f)]. At least 40% of the company's board must consist of independent directors (§ 10). Advisory contracts must first be approved by a majority of directors unaffiliated with the adviser or by a majority of shareholders [§ 15(c)]. Investment company transactions conducted by or with affiliated persons are prohibited in some cases and narrowly circumscribed in others (§ 17).

In 1938 (prior to the enactment of the 1940 Act), the Congress had amended the 1934 Act through the passage of the so-called "Maloney Act," 15 U.S.C. § 78o-3. The Maloney Act provided for the registration with the SEC of a national securities association with rule-making power upon the finding by the SEC that:

> the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.[13]

When Congress enacted the Maloney Act in 1938 it specifically provided:

> If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail. 15 U.S.C. § 78o-3(n)

The defendant NASD is the only securities association registered with the SEC under the Maloney Act.

By § 22(a) of the 1940 Act, Congress gave the NASD, as a registered national securities association, the power to promulgate rules setting the minimum price at which its members may buy redeemable fund shares from a fund, the maximum price at which its members may resell to or redeem with a fund, and the

[13] § 15A(b)(8), 15 U.S.C. § 78*o*-3(b)(8).

minimum period which must elapse after sale before a member may resell to or redeem with a fund. The SEC can exercise its overall supervisory power to promulgate rules superseding NASD's rules on sale, redemption and repurchase prices, holding periods, and sales loads [§ 22(c) 1940 Act].

Section 22(b)(1) of the 1940 Act empowers the NASD to adopt rules prohibiting members from charging "excessive" sales loads, provided that such rules "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters."[14] In so doing the NASD is expressly freed from a provision[15] in the Maloney Act which had prohibited it from issuing rules designed to impede "a free and open market," "fix minimum profits," "impose any schedule of prices," or "impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." Section 22(b)(3) of the 1940 Act, added in 1970, authorizes the SEC to alter and supplement, the NASD's Section 22(b)(1) rules.[16] And in 1970, Congress added Section 22(b)(4) to the 1940 Act to the effect:

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a-22(b)(4).

An investment company, its principal underwriter, and its dealers are prohibited from selling redeemable securities for

[14] Before 1970, then-Section 22(b) authorized the NASD to issue rules barring "unconscionable" and "grossly excessive" sales loads, and then-Section 22(c) empowered the SEC to issue superseding rules for both NASD members and non-members.

[15] § 15A(b)(8), 15 U.S.C. § 78*o*-3(b)(8).

[16] The SEC may also grant qualified exemptions from NASD rules for "smaller companies" [§ 22(b)(1)]. Section 22(b)(2), another 1970 addition, gives the SEC the same rate-fixing powers over non-NASD broker-dealers as Section 22(b)(1) gives the NASD over its members. An underwriter whose shares are distributed by non-members of NASD, however, may elect to have its shares sold under the NASD rather than the SEC sales load rule. [§ 22(b)(2)].

distribution to the public except at a current public offering price described in the prospectus [§ 22(d)]. Dealers and principal underwriters may, however, sell such securities to other dealers, the principal underwriter or the fund at other than a public offering price. (*Id.*)

An investment company may restrict the transferability and negotiability of its shares, but only insofar as that is done in conformity with the company's registration statement and not in contravention of SEC rules [§ 22(f)].[17]

By rules and regulations upon its own motion and by order upon application, the Commission may conditionally or unconditionally exempt persons, securities, or transactions, or classes thereof, from any provision in the Act or any rule or regulation thereunder, to the extent such exemption is in the public interest and not inconsistent with investor protection and the Act's purposes [§ 6(c)].[18]

Finally, no person may be held liable for any act done in conformity with an SEC rule, regulation, or order which is later invalidated [§38(c)]].

[17] The 1940 Act contains other provisions with respect to distribution. Redemption privileges may not be suspended or postponed for more than seven days after tender except during certain exceptional circumstances as defined by the SEC [§ 22(e)]. A fund may not issue shares for services or property other than cash or securities except as a dividend or shareholder distribution or in a reorganization [§ 22(g)]. Thus watering of shares is prevented.

Investment companies issuing periodic payment plan certificates may charge no more than a 9% sales load, nor deduct more than 50% of that load from the first year's payments, nor deduct disproportionate amounts, nor allow periodic payments of less than certain small amounts, nor make proceeds subject to management or other fees which exceed the amount the Commission prescribes as reasonable (§ 27). 1970 amendments added refund requirements and empowered the SEC to make rules with respect to reserves. (*Id.*)

Close-end funds are specially regulated with respect to watering and repurchase prices (§ 23).

[18] Baum v. Investors Diversified Services, 286 F.Supp. 914, 921 (N.D.Ill.1968), aff'd, 409 F.2d 872 (7th Cir. 1969).

Since 1940, the SEC has actively regulated the pricing and distribution of mutual fund shares. The Commission has promulgated a rule [19] for calculating fund share prices. It has promulgated another rule [20] allowing discount sales to certain groups and individuals and has periodically proposed[21] and adopted[22] amendments to this rule. It recently proposed a third rule[23] relating to no-load exchange privileges for fund shareholders who wish to switch to other load funds. The Commission has entertained a wide variety of applications for exemption from these rules and the relevant statutory sections and has granted some of these applications.[24] SEC administrative proceedings have barred both underpricing and overpricing of fund shares.[25]

[19] Rule 22c-1, 17 C.F.R. § 270.22c-1, adopted in Investment Co. Act Release No. 5519 (1969), CCH Fed.Sec.L.Rep. '67-'69 Decisions ¶ 77,616.

[20] Rule 22d-1, 17 C.F.R. § 270.22d-1, adopted in Investment Co. Act Release No. 2798 (1958).

[21] Investment Co. Act Release No. 5507 (1968), in CCH Fed.Sec.L.Rep. '67-'69 Decisions ¶ 77,609; Investment Co. Act Release No. 6069 (1970) in CCH Fed.Sec.L.Rep. '69-'70 Decisions ¶ 77,826 and Investment Co. Act Release No. 7571 (1972) in CCH Fed.Sec.L.Rep. '72-'73 Decisions ¶ 79,148.

[22] Investment Co. Act Release No. 6347 (1971), in CCH Fed.Sec.L.Rep. '70-'71 Decisions ¶ 77,953.

[23] Rule 22d-2, proposed in Investment Co. Act Release No. 7555 (1972), CCH Fed.Sec.L.Rep. '72-'73 Decisions ¶ 79,132.

[24] See the list of more than 100 such applications in 4 CCH Fed.Sec.L.Rep. at p. 68,751 et seq. The Commission staff has issued an abundance of letters in response to "no action" requests with respect to these rules and the basic statutory provisions. From 1971 through March 21, 1973, there were 49 such letters listed in 4 CCH Fed. Sec. L. Rep. at pp. 63,134; 63,789; and 63,894.

[25] *See, e. g., Spiro Sideris,* Exchange Act Release No. 8816 (1970) (underpricing); *Russell L. Irish,* Exchange Act Release No. 7687 (1965), CCH Fed.Sec.L.Rep. '64-'66 Decisions ¶ 77,274 (overpricing). The commission has also sought to regulate excessive "indirect" compensation to fund dealers. *E. g.,* SEC approval of new NASD Rules of Fair Practice. Section 26(k), which bars members from selling certain investment companies' shares in such a way that the companies will reciprocate with portfolio brokerage commissions, and conversely, Exchange Act Release No. 10147 (May 14, 1973), 5 Fed.Sec.L.Rep. ¶ 79,372.

The SEC has approved NASD Rule 26 which regulates in great detail the distribution, redemption, and repurchase of mutual fund shares.[26] The rule[27] says, *inter alia,* that principal underwriters must require their dealers to sign selling agreements containing certain restrictive provisions, that sales loads may not be "unfair," that the public offering price must be calculated in a particular fashion, that dealers and underwriters may not withhold customers orders or accumulate inventories, that certain conditional orders are barred, that the fund may not redeem at prices above net asset value, that sales loads must be refunded if the purchasers redeem soon after purchase, that fund shares may not be purchased at prices lower than the fund's next-quoted bid, and that non-contract dealers may not sell their shares back to the fund unless they are record owners of the shares. The SEC has supervised NASD enforcement of this rule and reviewed NASD enforcement proceedings.[28]

For more than three decades, since the enactment of the 1940 Act, the agreements between dealers and principal underwriters, and between principal underwriters and mutual funds, have been filed with the SEC. The agreements are filed under both the 1933 Act and the 1940 Act.[29] The Investment Trust Study of 1940 described such agreements in detail.[30] The 1940 Act specifically calls for written contracts between funds and their principal underwriter [§ 15(b)]. As noted above, the Commission has approved a NASD rule which requires dealer-underwriter agreements; and Commission decisions have fre-

[26] Proposed Amendment to the Rules of Fair Practice of National Ass'n of Securities Dealers, Inc., 9 SEC 38 (1941).

[27] NASD Rules of Fair Practice, Article III, Section 26 in CCH NASD Manual ¶ 2176.

[28] *See* note 25 *supra.*

[29] *See* Part IV *infra.*

[30] *See* note 47 *infra* and accompanying text.

quently turned on particular provisions of the dealer-underwriter agreements.[31]

III

THE OPERATION OF A MUTUAL FUND: RESALE PRICE MAINTENANCE

We look briefly at the manner in which a typical mutual fund operates within the foregoing framework.[32]

A mutual fund is an investment company which invests in the securities of other corporations and issues and has outstanding common stock representing an interest in the assets of the fund. The owner of the stock of the fund is entitled, on demand, to receive from the fund his proportionate share of the market value of the fund's net assets. To insure that the fund has sufficient cash or liquid assets on hand to meet current redemptions, the fund offers its common stock continuously. The offering price per share consists of the "net asset value" per share, computed daily, plus a sales charge or "load." The viability of a fund thus depends upon a distribution system which will effect continuous sales at prices which will support current redemption demands.

The primary distribution of the shares of a fund is controlled for the most part by § 22(d) of the 1940 Act and follows a basic pattern throughout the industry, *i. e.*, (1) a fund enters into a contract with a principal underwriter who has the

[31] *See, e. g.*, Mutual Funds Advisory, Inc., Investment Co. Act Release No. 6932 (Jan. 12, 1972); First Multifund of America, Inc., Investment Co. Act Release No. 6700 (1971), CCH Fed.Sec.L.Rep. '70-'71 Decisions ¶ 78,209 at p. 80,602; Russell L. Irish, Exchange Act Release No. 7687 (1965), CCH Fed.Sec.L.Rep. '64-'66 Decisions ¶ 77,274 at 82,431 n.13.

[32] *See generally* Investment Trust Study of 1940; Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R.Rep.No.2337, 89th Cong., 2d Sess. (1966) (hereinafter cited as Public Policy Report).

exclusive right to purchase the shares from the fund; (2) the principal underwriter acts only as a wholesaler supplying shares to retail dealers; (3) the retail dealers, who sell the shares to the investing public, are bound by contracts, commonly known as uniform sales agreements, with the principal underwriter which require that those dealers shall not sell at other than the public offering price, thus insuring that the price of the fund shares will not be the subject of competition among sellers of shares in the same fund; (4) the sales charge or "load" (which usually amounts to 7.5% to 8.5% above net asset value) is split between the underwriter and the dealer making the sale while the fund receives the net asset value component of the public offering price; and (5) when the shares are redeemed by the fund, as they must be upon demand, the redemption price is the net asset value prevailing at the time of redemption.

It is obvious from the foregoing outline of marketing procedures that the sale and distribution of mutual fund shares is accomplished through a retail price maintenance system which is patently repugnant to the free and open competition requirements of the Sherman Act. This price maintenance scheme, however, does not operate in a vacuum. Rather, it is expressly immunized from the otherwise applicable antitrust laws by virtue of the provisions of the 1940 Act and the Maloney Act. As the SEC recently reported to Congress, "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing.[33]

It has been authoritatively recognized that the Maloney Act, superimposed upon the regulatory scheme of the 1940 Act, provides a limited immunity for participants in the primary

[33] Public Policy Report 218-19. *See* Report of the Staff of the Securities and Exchange Commission on the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, pt. I, at 1 (November 10, 1972) [hereinafter cited as SEC Staff Report on Repeal of § 22(d)], CCH Fed.Sec.L.Rep.No.450 (Nov. 15, 1972) pt. II, at A-1.

distribution system of mutual fund shares under SEC-approved NASD rules. That exemption [34] was noted by Mr. Justice Frankfurter in his dissenting opinion in International Association of Machinists v. Street, 367 U.S. 740, 809-10 n. 16, 81 S.Ct. 1784, 1820, 6 L.Ed.2d 1141 (1961):

> The Maloney Act of 1938 added § 15A to the Securities Exchange Act of 1934. 52 Stat. 1070, 15 U.S.C. § 78o-3. In order to be registered, a number of statutory standards must be met. The statute specifically requires that an association's rules provide for democratic representation of the membership and that dues be equitably allocated. See § 15A(b)(5) and (6). Only one association, the National Association of Securities Dealers, Inc., has ever applied for or been granted registration. NASD membership comprises roughly three-quarters of all brokers and dealers registered with the Securities and Exchange Commission. Loss, Securities Regulation 766-67 (1951 Supp.1955). Sections 15A(i) and (n) of the Act authorize the NASD to formulate rules which stipulate that members shall refuse to deal with non-members with immunity from the antitrust laws. See S.Rep. No. 1455, 75th Cong., 3d Sess. 8-9 (1938); Loss, *op. cit., supra,* 769-770. The Commission has stated that it is "virtually impossible for a dealer who is not a member of the NASD to participate in a distribution of important size." National Association of Securities Dealers, Inc., 19 S.E.C. 424, 441.

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[34] *See also* the exemption from the antitrust laws provided by § 22(b) (4):

> If any provisions of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a-22(b) (4).

Again, in United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 227 n. 60, 60 S.Ct. 811, 846, 84 L.Ed. 1129 (1940), Mr. Justice Douglas stated:

> It should be noted in this connection that the typical method adopted by Congress when it has lifted the ban of the Sherman Act is the scrutiny and approval of designated public representatives. Under the N.I.R.A. this could be done through the code machinery with the approval of the President as provided in §§ 3(a) and 5, *supra* note 18. Under § 407(8) of the Transportation Act of 1920, [41 Stat. 482; 49 U.S.C. § 5(8)], carriers, including certain express companies, which were consolidated pursuant to any order of the Interstate Commerce Commission were relieved from the operation of the Antitrust Laws. *And see the Maloney Act (§ 15A of the Securities Exchange Act of 1934, 52 Stat. 1070, 15 U.S.C.A. § 78o-3) providing for the formation of associations of brokers and dealers with the approval of the Securities and Exchange Commission and establishing continuous supervision by the Commission over specified activities of such associations . . . .* (Emphasis added.)

The plaintiffs recognize a limited antitrust immunity accorded to the primary distribution system. The gravamen of their complaints, however, is that the defendants have conspired to use the primary distribution system to foreclose the development of a secondary market in mutual fund shares. This is allegedly accomplished through the use of the uniform sales agreements mentioned above, which even after primary distribution of the shares, set the price at which the shares shall thereafter be sold, thus precluding the dealers from selling shares as brokers in a brokerage market or as dealers in a secondary dealer market in which marketplace conditions and arms-length bargaining would be the price-setting factors. The plaintiffs insist that Congress, while allowing the primary

market to flourish with benefit of antitrust immunity, did not intend to foreclose secondary market growth, but that such secondary markets are in fact being discouraged and suppressed by certain NASD rules and the restrictive provisions contained in the industry-wide uniform sales agreements between principal underwriters and dealers.

IV

SECTION 22, 1940 ACT

[1] The fact that a secondary market is to all intents and purposes non-existent might seem to substantiate the plaintiffs' claims. However, the position of the plaintiffs fails to take into account that the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urged upon Congress with no success. It is an economic fact, recognized by Congress, that the two markets—the primary market described in Part III *supra*, and a secondary market as urged by the plaintiffs—cannot co-exist and both remain viable. Having established a resale price maintenance system in the primary distribution system in which ordinary competitive influences cannot operate, Congress has rejected all attempts to foster a secondary market which might operate to the detriment of the primary market.

In support of those conclusions we look to the legislative history of the key sections of the 1940 Act and to the congressional intent in enacting that legislation.

A. *Section 22(d)*

Section 22(d) provides in pertinent part,

> . . . no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

As written, and as applied, that language clearly contemplates a congressionally sanctioned retail price maintenance system which is inconsistent and in conflict with the antitrust laws so far as underwriters and dealers are concerned.

Plaintiffs assert, however, that since the term "broker" or "broker-dealer" is not used in the subsection, that 22(d) permits a person to sell to another through a broker at a price less than the specified public offering price for the same shares, and that the absence of a significant brokerage market in those shares implies the existence of conspiratorial anti-competitive activity on the part of defendants to prevent the growth of that market.

This argument, however, ignores the price maintenance purpose of § 22(d) and its corollary that there must not be price discrimination between similarly situated investors.

On this latter point, so far as this Court is aware, there is no SEC or SEC staff pronouncement which can be construed to sanction price discrimination between similarly situated investors. To the contrary the SEC has said:

> The purposes of the Section [22(d)] are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus. Investment Company Release No. 2798 (December 2, 1958). *See also* Investment Company Release Nos. 8816 (February 13, 1970); 2718 (May 29, 1958); 89 (March 13, 1940). *See* In the Matter of Investors Diversified Service, 39 SEC 680 (1960).

Again, in its most recent annual report the SEC has stated:

> Section 22(d) precludes the sale to public investors of redeemable investment company securities which are being currently offered to the public on or through an underwriter except at a current public offering price described in the prospectus. SEC, *Thirty-eighth Annual Report* 97.

Thus, the language of the statute, its legislative history and subsequent interpretation by the SEC all indicate that its object was to allow the pre-1940 method of mutual fund share distribution to continue subject to the changes necessary to suppress what was sometimes dubbed the "bootleg" market. Greene, The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940, 37 U.Det.L.J. 369, 371 (1960); In the Matter of Spiro Sideris, Securities Exchange Act Release No. 8816 (Feb. 13, 1970).

The legislative history of § 22 indicates that in the pre-1940 period there was in fact a secondary market very similar in size and scope as that for which plaintiffs here attempt to make a case.[35] This market—the "bootleg market"—was being maintained by brokers and dealers who were not under contract with the issuers or underwriters and who were not, accordingly, a part of the established distribution system of any given fund.

Those non-contract broker-dealers, without the authority of fund underwriters and in competition with authorized retail distributors of mutual fund shares, were buying shares in the market directly from shareholders at a price slightly above the published redemption price and reselling them to investors at

[35] Hearings on S.3580 Before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (1940); Hearings on H.R.10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. (1940); S.Rep.No.1775, 76th Cong., 3d Sess. (1940); H.R.Rep.No.2639, 76th Cong., 3d Sess. (1940); Hearings on S.1659 Before the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. (1967); Hearings on H.R.9510 and H.R.9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foeign Commerce, 90th Cong., 1st Sess. (1967); S.Rep.No.1351, 90th Cong., 2d Sess. (1968); Hearings on S.34 and S.296 Before the Senate Comm. on Banking and Currency, 91st Cong., 1st Sess. (1969); Hearings on H.R.11995, S.2224, H.R.13754 and H.R.14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 1st Sess. (1969); S.Rep.No.184, 91st Cong., 2d Sess. (1969); H.R.Rep.No.1382, 91st Cong., 2d Sess. (1970); H.R.Rep.No.1631, 91st Cong., 2d Sess. (1970).

prices lower than those fixed by the funds' principal underwriters.[36] Contract dealers operating in the primary distribution-system, on the other hand, were obligated by their distribution contracts to sell fund shares at the price (including the sales charge) set by the principal underwriters.

Thus, non-contract dealers were effectively by-passing the primary distribution system and retaining for themselves the selling commissions in full.[37] If investors bought in the secondary market but redeemed through the fund, it was feared that redemptions would exceed sales of new shares and the fund would no longer have the cash available to satisfy its redemption obligations. Thus if the proceeds of new sales did not accrue to the fund, forced liquidation might result.

The congressional response to the problems of the pre-1940 market conditions was § 22. By § 22(f), *infra*, a fund was given the right to limit transferability. By § 22(d), all dealers were required to maintain the public offering price in sales to the public. The effect of the Act was for the first time to bind non-contract dealers to the public offering price. A stated purpose of § 22(d) was to insure that "no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors."[38]

This was a clear recognition that cut-price competition resulted in discrimination between similarly situated investors.

"Another factor in the decision to give statutory sanction to price fixing in 1940 was the fact that mutual fund distribution was then and for many years thereafter conceived of as a specialized type of underwriting, and underwriting was regarded as a field in which the law sanctioned price fixing." 1967

[36] Investment Trust Study of 1940, 865; *see also* Hearings on H.R.9510 and 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 90th Cong., 1st Sess. 59 (1967) (hereinafter cited as 1967 House Hearings).

[37] Investment Trust Study of 1940, 864; Public Policy Report 219.

[38] 1940 Senate Hearings 1057.

Senate Hearings 153-54 (Chairman Cohen). *Cf.* United States v. Morgan, 118 F. Sup. 621, 697 (S.D.N.Y.1953).

As alluded to *supra,* a very real danger of the "bootleg" market was that its short term price advantage would drain profits from the primary distribution system and leave the issuers unable to engage in continuous sales of new securities necessary for long-term growth and the financial health of a fund. According to one commentator, a purpose of the price maintenance provisions was "to prevent the cut-price competition which had then been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms." Greene, Uniform Offering Price, *supra,* 37 U.Det.L.J. at 371.

Section 22(d) has been reconsidred by Congress several times. Its modification or repeal has been urged. Congress has consistently refused to modify or repeal it, and in the course of hearings on various proposals, the position of the SEC and the congressional intent are clearly reflected. For example, in 1967 Congress was re-examining the problems of public offering prices and sales loads. It was being urged that competition for sales loads could only be realized by a repeal of 22(d). While testifying before the Senate Committee, then-Chairman of the SEC Cohen remarked:

> However, this argument [that 22(d) be repealed to allow competition] overlooks a fundamental theme of state and federal securities regulation. Securities regulation has done a good deal for the knowledgable investors, principally by increasing the quantity and improving the quality of the information available to them. But one of its primary concerns has always been the welfare of the unsophisticated investor, who is often the one most likely but least able to bear the burden of high charges in a competitive market. If it is desirable for millions of unsophisiticated investors of modest means to invest in securities through the medium of mutual funds, it is also desirable that they should not subsequently have cause to believe that they were unfairly dealt with. On balance, we concluded therefore that a modification of the manner in which sales charges on mutual fund shares are now regulated was more consonant with the spirit and purpose of the securities laws than the elimination of Section 22(d). We therefore recommended that sales charges be limited to 5% of the amount invested, with authority in the Commission to raise this limit in appropriate situations.[39]

It is significant to note, that in the same hearings, some participants recognized that brokerage transactions, necessarily executed in the secondary market, were within the prohibition of § 22(d).

Senator Proxmire, for example, asked whether or not the SEC would recommend the repeal of 22(d) "in order to permit price competition in the sale of the same mutual fund by various broker-dealers."[40] Senator Mondale stated that section "22(d) permits—indeed makes it illegal for *agents* to sell at a sales charge less than that prescribed by the company,[41] while Professor Paul Samuelson, Massachusetts Institute of Technology, testified that "Congress should repeal the provision in section 22(d) of the Investment Company Act of 1940 which prohibits a *broker* from selling mutual fund shares to the public at less than the public offering price."[42] Later in the hearings, Senator Mondale again remarked that "Section 22(d) makes it illegal for an *agent* to charge less than his company says he must charge as an *agent's fee,* but it does not prohibit or have anything to do with competition as between companies."[43]

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[39] Hearings on S.1659 Before the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 154-55 (1967) (hereinafter cited as 1967 Senate Hearings).

[40] *Id.* 51-52.

[41] *Id.* 275 (emphasis added).

[42] *Id.* 348 (emphasis added).

[43] *Id.* 769 (emphasis added).

Similar statements appear in the House Hearings, including the following exchange between Congressman Watkins and then-SEC Chairman Cohen:[44]

> Mr. Cohen. The statute now, and since 1940, interferes with competitive business in this area.
>
> Mr. Watkins. Not to the extent you are proposing.
>
> Mr. Cohen. I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.
>
> Mr. Watkins. True.

In the same House Hearings, the Department of Justice, while urging the repeal of 22(d), characterized its provisions as follows:

> It is true that Congress, in originally enacting the "fixed price" provisions of Section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws. In view of changed conditions, however, and the fact that the mutual funds are so important an outlet for the small investor, it would seem that he should not perhaps be deprived of the opportunity of purchasing his investment at a price arrived at through the free operation of competitive forces.[45]

The SEC took the same view. The then-Chairman Cohen stated that "sellers of mutual fund securities have been insulated by Federal Law from price competition at the retail level ever since 1940" (1967 Senate Hearings 26), and that § 22(d) "provides an exemption from the antitrust laws" (1967 House Hearings 1940). Furthermore, the Sec's view that

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[44] 1967 House Hearings 711.

[45] *Id.* 21 (letter from Warren Christopher, Deputy Attorney General, to Chairman Harley O. Staggers, October 18, 1967).

§ 22(d) requires retail price maintenance by broker-dealers who are members of the primary distribution system is also evident in its acceptance of NASD Rule 26(e), which provides that "no member shall offer or sell any such security except at the effective public offering price described in the current prospectus of the issuing company . . . ." CCH NASD Manual ¶ 2176.

The same thread runs through hearings conducted in 1969,[46] again with a view to the modification or repeal of §22(d). In the 1969 Senate report, we find these comments on § 22(d):

> The provision for "reasonable loads to investors" is intended to assure that the sales loads fixed by the principal underwriters (*which continue to be protected against price competition by Section 22(d) of the act*) will be established at levels which recognize the interests of investors.
>
> The provisions of this proposed section shall prevail over any conflicting provision of Federal law. This provision, *which is identical to Section 15A(n) of the Securities Exchange Act, is designed to make it clear that no other provision of Federal law, including the antitrust laws,* prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section. S.Rep.No.184, 91st Cong., 1st Sess. 18 (1969) (emphasis added).
>
> The basic sales commission charged for mutual fund shares is in most instances about 8½ percent of the total payment or 9.3 percent of the amount invested.

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[46] Hearings on S.34 and S.296 Before the Senate Comm. on Banking and Currency, 91st Cong., 1st Sess. (1969); Hearings on H.R.11995, S.2224, H.R.13754 and H.R.14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 1st Sess. (1969).

> *This charge is protected by Section 22(d) of the Investment Company Act which provides for a unique scheme of retail price maintenance. Under this section, all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime.*
>
> In its deliberations your committee considered the possibility of deleting Section 22(d) from the act. However, impressive testimony was given that there had not been sufficient study of the consequences of such an amendment. Therefore, your committee requests the Securities and Exchange Commission to review the consequences of such a proposal on both the investing public and mutual fund sales organizations and report to it as soon as is reasonably practicable. *Id.* 7-8 (emphasis added).

It is thus conclusively established that competition in the sale of a single fund's shares is effectively precluded by the 1940 Act which was intended, via § 22(d), to prevent the sale of fund shares at a price less than that fixed in the current prospectus. It is obvious that Section 22(d) of the 1940 Act was premised upon a congressional understanding that principal underwriters and broker-dealers were exempt from the antitrust laws when entering into uniform sales agreements for mutual fund shares. It is also obvious that even at the expense of a secondary market Congress intended to maintain the resale price maintenance system. Congressional intent is entitled to substantial weight lest this Court "change the design that Congress fashioned." State Board of Insurance v. Todd Shipyards Corp., 370 U.S. 451, 458, 82 S.Ct. 1380, 1385, 8 L.Ed.2d 620 (1962).

B. *Section 22(f)*

[2] Section 22(f) is a necessary companion to § 22(d). If the problems of the competitive market created by non-contract brokers were to be met, restrictions on alienability were necessary. And Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Paraphrased, that language states clearly that if (1) restrictions on transferability or negotiability are included in the registration statement, and if (2) these restrictions are not in contravention of such rules and regulations as the commission may prescribe in the interest of the shareholders, then such restrictions are permissible even if they create departures from antitrust standards.

As noted above in the discussion of § 22(d), Congress considered the 1940 Act in the light of then-existing conditions, particularly the disruptive influence upon the market in mutual fund shares by the practices of non-contract dealers and brokers.

To overcome this disruptive competition prior to the enactment of the 1940 Act, some funds restricted the alienability of their shares, "providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company." [47] Such restrictions were usually included in the share certificates.[48]

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[47] Investment Trust Study of 1940, 865.

[48] 1940 Senate Hearings, 292 (remarks of SEC General Counsel David Schenker).

From and after 1940, § 22(f) required that any restriction on alienability be included in the registration statements and, additionally, that they be subject to the rule-making authority of the SEC. Clearly, by § 22(f) Congress specifically empowered mutual funds to restrict the tranferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rule-making authority of the SEC. Just as clearly Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications.

Restrictions on alienability have consistently appeared in registration statements and in uniform sales agreements since the passage of the 1940 Act. Not only are such contracts required by SEC-approved Rule 26 of the NASD Rules of Fair Practice, CCH NASD Manual ¶ 2176, but they are also disclosed in the registration statements. It is undisputed that these agreements have remained virtually unchanged since they were first filed with the SEC along with and as part of the registration statements. It is also undisputed that the SEC has never challenged the validity of uniform sales agreements. Indeed, the SEC has noted that these agreements require a dealer "to place all orders with the principal underwriter and to refrain from any attempt to obtain shares from other sources."[49]

It is thus apparent that Congress designed §§ 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is "incompatible with the maintenance of (an) antitrust action."

[49] SEC Staff Report on Repeal of § 22(d) A-109. *See* Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R.Doc.No.95, 88th Cong., 1st Sess. 98 (1963), wherein reference is made to the "fair trade arrangements established by the Act, the NASD rules and private sales agreements . . ."; Greene, Uniform Offering Price, *supra,* 37 U.Det.L.J. at 371-72.

Silver v. New York Stock Exchange, 373 U.S. 341, 358, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1963).

Whether the mutual fund marketing structure mandated by Congress in 1940 should be eliminated or modified is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide. In fact, in urging its complaint upon the Court, one of the plaintiffs, *viz.,* the Department of Justice, seeks to accomplish indirectly what it has failed, so far, to achieve directly—the repeal or modification of § 22(d)—in hearings before both Congress[50] and the SEC.[51]

V

IMPLIED IMMUNITY

[3] Even if a specific exemption granted by the Maloney Act were deemed to be inadequate to grant immunity from the impact of the antitrust laws, the defendants urge that the 1940 Act, particularly § 22 thereof, created a pervasive regulatory scheme which highlighted the Congressional intent to immunize the investment company industry from the impact of the antitrust laws.

The plaintiffs, on the other hand, urge that repeals of the antitrust laws by implication are "strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." They argue that, in the instant case, plain repugnancy is not apparent.

The most recent pronouncement of the Supreme Court on this particular point is to be found in Hughes Tool Company v. Trans World Airlines, 409 U.S. 363, 93 S.Ct. 647, 34 L.Ed.2d 577 (1973).

In *Hughes Tool* the respondent TWA challenged as violative of the antitrust laws certain transactions and activities of

[50] 1967 House Hearings.

[51] In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, SEC File No. 4-164 (1973).

petitioner Hughes Tool (Hughes). The Supreme Court, dismissing the action, held that the challenged transactions "were under the control and surveillance of the Civil Aeronautics Board" (CAB); that pursuant to the Federal Aviation Act of 1968 the CAB applying antitrust standards has reviewed the same kind of conduct which TWA alleged to be violative of the antitrust laws. The Court stated:

> In this context, the authority of the Board to grant the power to "control" and to investigate and alter the manner in which that "control" is exercised leads us to conclude that this phase of CAB jurisdiction . . . pre-empts the antitrust field. 409 U.S. at 385, 93 S.Ct. at 660 (footnote omitted).

And the Court further stated that where the CAB authorizes control of an air carrier to be acquired by another person or corporation and where the CAB specifically authorizes as in the public interest specific transactions between the parent and the subsidiary, the way in which that control is exercised in those precise situations is under the surveillance of CAB, not in the hands of those who can invoke the sanctions of the antitrust laws. 409 U.S. at 387, 93 S.Ct. at 661.

Further, the Court said that its holding was "consistent with the view expressed in Silver v. New York Stock Exchange . . . that a statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances *by implication* grant immunity from an antitrust claim." 409 U.S. at 385 n.14, 93 S.Ct. at 660 (emphasis added).

The Court in *Hughes Tool* relied heavily on its prior decision in Pan American World Airways v. United States, 371 U.S. 296, 83 S.Ct. 476, 9 L.Ed.2d 325 (1963), which also involved the pervasive regulatory scheme of the CAB and an implied repeal of the antitrust laws. In *Pan American* the Court found that the Sherman Act could not be applied to matters which the CAB had approved in exercising its statutory function.

> It would be strange, indeed, if a division of territories or an allocation of routes which met the requirements of "public interests" as defined in § 2 were held to be antitrust violations. . . . If the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide. 371 U.S. at 309-10, 83 S.Ct. at 484.

The Court then found that the implementation of antitrust policy in the public interest was for the CAB, under the Federal Aviation Act's comprehensive regulatory scheme, and not for the courts. In the case at bar, as in *Hughes Tool* and *Pan American,* there exists a pervasive regulatory scheme coupled with a legislative history manifesting congressional intent to immunize the investment company industry from the operation of the antitrust laws to the limited extent necessary to carry out the purpose of the independently defined federal policy legislated in the regulatory act, *i.e.,* the Investment Company and Maloney Act.[52]

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[52] In Hecht v. Pro-Football, Inc., 144 U.S. App.D.C. 56, 444 F.2d 931 (1971), cert. denied, 404 U.S. 1047, 92 S.Ct. 701, 30 L.Ed.2d 736 (1972), the Court held the following to be relevant criteria for determining which conduct is immune from the antitrust laws:

> Putting the problem in this light, relevant criteria would include the specific language of the congressional statute involved, any legislative history which would throw light on the congressional intent, the relative importance of the governmental action which is asserted to override antitrust policy, whether the governmental agency is required to take into consideration the possible anticompetitive effect of its actions, whether the agency is required to adhere to a clearly defined and restricted statutory directive, and to what extent the agency's actions are subject to judicial review. 144 U.S.App.D.C. at 60, 444 F.2d at 935.

See also Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264, 270 (7th Cir. 1970), cert. denied, 401 U.S. 994, 91 S.Ct. 1232, 28 L.Ed.2d 532 (1971), where the Court also discussed immunity criteria; United States v. Morgan, 118 F.Supp. 621 (S.D.N.Y.1953).

The decisions in *Hughes Tool* and *Pan American* are consistent with the views expressed in Silver v. New York Stock Exchange, *supra,* where the Supreme Court held that the Stock Exchange was not exempt from the antitrust laws when, pursuant to its rules, it ordered its members to remove certain telephone connections they had with the offices of a non-member. Although the Exchange was generally regulated by the Securities Exchange Act of 1934, the Court noted that the SEC lacked jurisdiction to review cases such as petitioner's where the Exchange has enforced its rules. Silver v. New York Stock Exchange, *supra,* 373 U.S. at 358, 83 S.Ct. 1246.

The Court's opinion in *Silver* turned on the fact that there was no justification for the Exchange rule under the Securities Exchange Act because that rule did not provide any procedural safeguards for the petitioner. The Court did find, however that "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." 373 U.S. at 361, 83 S.Ct. at 1259. The Court noted further that "(s)hould review of exchange self-regulation be provided through a vehicle other than the anti-trust laws, a different case as to anti-trust exemption would be presented. See note 12, *supra.*" 373 U.S. at 360, 83 S.Ct. at 1258. The Court's reference, "note 12," refers expressly to the SEC's jurisdiction under the Maloney Act and states that were there such SEC jurisdiction in a *Silver*-type situation, "a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity . . . " 373 U.S. at 358 n.12, 83 S.Ct. at 1257.[53]

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[53] *But see* Harwell v. Growth Programs, Inc., 451 F.2d 240 (5th Cir. 1971), reh. denied, 459 F.2d 461, cert. denied, 409 U.S. 876, 93 S.Ct. 126, 34 L.Ed.2d 129 (1972), where the Court applied the *Silver* rationale to self-regulatory activities of the NASD. *Harwell,* however, did not involve a claim of limited antitrust immunity under § 22 of the 1940 Act.

This Court is persuaded that the instant case is that "different case."[54] The Investment Company Act and the Maloney Act read together demonstrate that Congress intended to eliminate free competition in the distribution of mutual fund shares. The language of both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency.[55] The SEC and the NASD have the statutory authority to control the area and both have in fact taken an active role. The NASD, under the control and supervision of the SEC, has adopted specific rules to govern the activities of principal underwriters and broker-dealers. The Maloney Act, Section 15A(b)(8), specifically requires the SEC to employ antitrust standards, *i.e.,* "to protect the public interest," when reviewing the rules promulgated by the NASD.[56] Still further, the SEC has adopted

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[54] *Cf.* Gordon v. New York Stock Exchange, Inc., et al., 366 F.Supp. 1261 (S.D.N.Y.1973), where the Court, in dismissing an antitrust attack on the commission structure of both the New York and American Stock Exchanges, found that the fixing of commissions falls within the congressional policy of exchange self-regulation embodied in the Securities Exchange Act of 1934.

[55] In Baum v. Investors Diversified Services, Inc., 286 F.Supp. 914 (N.D.Ill.1968), aff'd on other grounds, 409 F.2d 872 (7th Cir. 1969), the plaintiff alleged a violation of the Robinson-Patman Act. After reviewing the SEC involvement, the court held:

> The foregoing demonstrates that the SEC has exercised its broad regulatory authority in this industry to establish a framework of pricing practices within which investment companies must operate. It has specifically approved the alleged discriminatory pricing system under attack in the case at hand, and has justified the system as being "in the public interest and consistent with the protection of investors and purposes fairly intended by the policy and provisions of this Title." 286 F.Supp. at 924.

[56] *See also* Section 6(c) of the 1940 Act which empowers the SEC to "exempt any person, security, or transaction . . . from any provision" of the Act "if and to the extent that such exemption is necessary or appropraite in the *public interest* and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. 15 U.S.C. § 80a-6(c) (emphasis added).

rules specifically designed to govern *non*-NASD members in the distribution and redemption of mutual fund shares. *See* 15 U.S.C. § 78o(b)(8)-(10). In connection with its regulatory function, the SEC has extensively reviewed the distribution and redemption practices in the investment company securities industry and even has reviewed the secondary market for such securities.[57]

This Court's opinion is further strengthened by the Supreme Court's decision last Term in United States v. Cartwright, 411 U.S. 546, 93 S.Ct. 1713, 36 L.Ed.2d 528 (1973). That case challenged a regulation issued by the Secretary of the Treasury covering valuation of mutual fund shares for Federal Estate Tax purposes. The Court at least impliedly recognized the pervasive regulatory scheme in the investment company industry.

> Private trading in mutual fund shares is virtually nonexistent. Thus at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund, at the "asked" price, which includes the load. But shareholders "sell" their shares back to the fund at the *statutorily* defined redemption or bid price. 411 U.S. at 549, 93 S.Ct. at 1715 (emphasis added).

The Court went on to state that the regulation in question was "manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operates without regard for the market in mutual fund shares that the Act *created and regulates.*" 411 U.S. at 557, 93 S.Ct. at 1719 (emphasis added).

The plaintiffs place great reliance on other recent Supreme Court decisions. Principally they rely upon Otter Tail Power

[57] *See, e. g.*, Public Policy Report; SEC Staff Report on Repeal of § 22(d): In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940, SEC File No. 4-164 (1973).

Co. v. United States, 410 U.S. 366, 93 S.Ct. 1022, 35 L.Ed.2d 359 (1973), in which the Court refused to imply immunity from the antitrust laws. Plaintiffs cite *Otter Tail* to show that even extensive regulation of an industry does not thereby immunize that industry from the antitrust laws. The Court's language is clear and unequivocal, however, for it found congressional intent *not* to displace the antitrust laws, but rather to retain the applicability in order to promote competition. That is not the case here.

> It is clear, then, that *Congress rejected a pervasive regulatory scheme for controlling the interstate distribution of power in favor of voluntary commercial relationships. When these relationships are governed in the first instance by business judgment and regulatory coercion,* courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws. *See* United States v. Radio Corporation of America, *supra,* 358 U.S. 334, at 351, 79 S.Ct. 457, 3 L.Ed.2d 354. This is particularly true in this instance because Congress, in passing the Public Utility Holding Company Act, . . . was concerned with "restraint of free and independent competition" among public utility holding companies. See 15 U.S.C. § 79a(b)(2). 410 U.S. at 374, 93 S.Ct. at 1028 (emphasis added).

Otter Tail accordingly is not controlling.

Nor does Federal Maritime Commission v. Seatrain Lines, Inc., 411 U.S. 726, 93 S.Ct. 1773, 36 L.Ed.2d 620 (1973), support plaintiffs' position. That case dealt with the scope of an express repealer of the antitrust laws in the 1916 Shipping Act[58] which by its terms, limited antitrust immunity to conference agreements approved by the Federal Maritime Commission (FMC). At issue was whether an agreement which confers no

[58] 46 U.S.C. §814. See Note, the Shipping Industry Seeks a Safe Haven: Merger Jurisdiction for the FMC?, 5 Law & Pol. Int'l Bus. 274 (1973).

ongoing obligations is an "agreement" within the meaning of the Act. The Court held that Congress did not intend to invest the FMC with the power to shield from antitrust liability mergers which create no continuing responsibilities. Furthermore, the Court found in examining the legislative history there was an overriding federal policy to promote competition. Since the FMC's power to immunize agreements from the antitrust laws was limited only to those agreements approved by it, this Court fails to see in what manner the claim for limited immunity in the present case offends the *Seatrain* principle since there is no similar requirement conditioning exemptions in the 1940 Act.[59]

This Court is not, of course, unmindful of the fact that "(r)epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." United States v. Philadelphia National Bank, 374 U.S. 321, 350-351, 83 S.Ct. 1715, 1734, 10 L.Ed.2d 915 (1963) (footnotes omitted). *See also* United States v. McKesson & Robbins, Inc., 351 U.S. 305, 316, 76 S.Ct. 937, 100 L.Ed. 1209 (1956); California v. FPC, 369 U.S. 482, 82 S.Ct. 901, 8 L.Ed.2d 54 (1962); United States v. Borden Co., 308 U.S. 188, 60 S.Ct. 182, 84 L.Ed. 181 (1939). That principle, of course, rests upon the sound basis that "antitrust laws represent a fundamental national economic policy." Carnation Co. v. Pacific Westbound Conference, 383 U.S. 213, 218, 86 S.Ct. 781, 784, 15 L.Ed.2d 709 (1966).[60] With that fundamental policy in mind, the Court does not hold that the Investment Company Act and the Maloney Act "completely displace the antitrust laws." *Hughes Tool, supra,* 409 U.S. at 389, 93 S.Ct. 647. What the Court does find is a "limited antitrust exemption." *Carnation Co., supra,* 383 U.S. at 219, 86 S.Ct. 781. Here, given the fact that Congress clearly intended to substitute a pervasive regulatory scheme, *i.e.,* § 22 of the 1940 Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is clear that the price maintenance practices complained of are immune from ordinary antitrust strictures.[61]

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[59] *Cf.* Ricci v. Chicago Mercantile Exchange, 409 U.S. 289, 302-303 n. 13, 93 S.Ct. 573, 34 L.Ed.2d 525 (1973), where the Court recognized that where a regulatory act contains an express exemption from the operation of the antitrust laws, or where a regulatory agency is specifically directed to consider competitive factors in the exercise of its duties, it is necessary to conclude that Congress intended to exempt from the antitrust laws activity subject to the administrative agency's adjudicative or rule-making authority.

Moreover, the cases at bar do not involve the doctrine of primary jurisdiction. *See, e. g.,* Chicago Mercantile Exchange v. Deaktor, 414 U.S. 113, 94 S.Ct. 466, 38 L.Ed.2d 344 (1973); Ricci v. Chicago Mercantile Exchange, *supra.*

[60] *See, e.g.,* United States v. Borden Co., 308 U.S. 188, 200, 60 S.Ct. 182, 84 L.Ed. 181 (1939). *Cf.* Maryland & Virginia Milk Producers Ass'n Inc. v. United States, 362 U.S. 458, 80 S.Ct. 847, 4 L.Ed.2d 880 (1960).

[61] Notwithstanding this conclusion, two SEC rulings, cited by plaintiffs, in support of their contention that the price maintenance requirements of § 22(d) would not apply if the broker-dealer acted in the capacity of a broker rather than a dealer, deserve mention. One is an Opinion of SEC General Counsel, Investment Company Act Release No. 87 (March 14, 1941). In response to an abstract inquiry, the General Counsel thought that the term "dealer" in § 22(d) "refers" to the capacity in which a broker-dealer is acting in a particular transaction." He concluded that when a broker-dealer acts as a broker in a specific transaction, he is not bound to sell at the public offering price. In the Matter of Oxford Co., Inc., 21 SEC 681 (1946), involved a disiplinary proceeding for a broker-dealer alleged to have violated his fiduciary duty to his clients. There the broker-dealer sold mutual fund shares from one of his accounts to another related account, charging the public offering price and retaining the sales load for himself. The SEC, citing the General Counsel's opinion, rejected the technical defense that the subject's actions were mandated by § 22(d).

The Court concludes that reliance on these two decisions is misplaced. They are *ad hoc* decisions in no way related to the regulated distribution system. Furthermore, they do not address the problem of likely discrimination between similarly situated investors. Such shortcomings preclude a basis for allowing industry-wide cut-price competition in brokerage transactions contrary to the purposes of § 22(d).

VI

CONCLUSION

In light of the foregoing, the Court concludes that the plaintiffs in each of the above-captioned cases have failed to state a claim upon which relief can be granted, and that accordingly the motions to dismiss in each such case must be granted. Orders are filed herewith.

ORDERS IN NOS. 2454-72, 338-73, 426-73.

This matter having come on for ruling on the defendants' motions pursuant to Rule 12 of the Federal Rules of Civil Procedure to dismiss the complaint for failure to state a claim upon which relief can be granted, the parties having filed briefs in support of their respective positions, and the Court being fully advised in the premises and having issued its Memorandum Opinion on December 14th, 1973;

It is this 14th day of December, 1973,

Ordered that the above-captioned case be, and the same is, hereby dismissed on the merits and with prejudice for failure to state a claim upon which relief can be granted.

ORDER IN NO. MISC. 103-73.

Upon the Court's own motion, it is this 14th day of December, 1973,

Ordered that all further proceedings relating to (1) answers or motions with respect to the complaints, (2) class certification, and (3) discovery, by any party in any case in the above-captioned action heretofore or hereafter filed in this Court are stayed pending further order of this Court following disposition of any appeal from the Orders entered by this Court on December 14, 1973, in Haddad v. The Crosby Corp., et al., Civil Action No. 2454-72; United States v. National Association of Securities Dealers, Inc., Civil Action No. 338-73; and Gross, et al. v. National Association of Securities Dealers, Inc., et al., Civil Action No. 426-73.

So ordered:

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1347

GENEVIEVE M. HADDAD, INDIVIDUALLY AND REPRESENTATIVELY ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, APPELLANT

v.

THE CROSBY CORPORATION, ET AL

Appeal from the United States District Court for the District of Columbia

(D.C. Civil Action 2454-72)

Submitted without argument—17 February 1976

Decided 6 April 1976

Eugene J. Metzger and *Carl W. Schwarz*, were on the brief for appellant.

Lee Loevinger and *David J. Saylor*, were on the brief for appellees Bache & Co., Inc., Blythe Eastman Dillon & Co., Dean Witter & Co., Inc., Hayden Stone, Inc., Hornblower & Weeks-Hemphill, Noyes, Inc., E.F. Hutton & Co., Inc., W. E. Hutton & Co., Merrill Lynch, Pierce, Fenner & Smith, Inc., Paine, Webber, Jackson & Curtis, Inc., Reynolds Securities Inc., and Thomson & McKinnon Auchincloss, Inc.

Robert E. Jensen and *Richard M. Phillips* were the brief for appellees Wellington Management Company.

J. Sumner Jones was on the brief for appellees Institutional Equity Corp. and Summit Management & Research Corp.

William H. Jeffress, Jr., was on the brief for appellees Vance, Sanders & Company, Inc.

Michael H. Diamond was on the brief for appellees The Crosby Corporation, Fidelity Management & Research Co., Edward C. Johnson, II, Edward C. Johnson, III, C. Rodgers Burgin, William L. Byrnes, Alfred B. Cornell, Gilbert H. Hood, Jr., George K. McKenzie, George S. McEwan, Horace Schermerhorn, D. George Sullivan and Caleb Loring Jr.

John T. Tansey was on the brief for appellees Piedmont Capital Corp. and Lexington Management Corporation.

Rodney Page was on the brief for appellee American Funds Distributors, Inc.

Edgar H. Brenner and *Kenneth A. Letzler*, were on the brief for appellee Investment Company Institute.

Joseph B. Levin was on the brief for appellee National Association of Securities Dealers, Inc.

Before: BAZELON, *Chief Judge*, WILKEY, *Circuit Judge* and MERHIGE,* *Judge, United States District Court* for the Eastern District of Virginia

Per Curiam: This appeal arises out of District Judge Corcoran's dismissal[1] of a broadly based private antitrust action[2] against numerous individuals and organizations associated with load mutual funds, or the distribution or trading of their shares.[3] The primary thrust of the complaint is that

* Sitting by designation pursuant to 28 U.S.C. §292(d) (1970).

[1] *In re Mutual Fund Sales Antitrust Litigation*, 374 F.Supp. 95 (D.D.C. 1973).

[2] The complaint alleges restraints of commerce in violation of Sections 1, 2, and 3 of the Sherman Act, 15 U.S.C. §§ 1, 2, 3 (1970), and "combination, conspiracy, scheme, artifice and common device to defraud and deceive" in violation of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (1970), the Investment Company Act of 1940, 15 U.S.C. §§ 90a-1, *et seq.* (1970), and particularly rule 10b-5 issued pursuant to the 1934 Act. 17 C.F.R. § 240.10b-5 (1975). *Complaint, App. to Petitioners' Br.* at 23, 29.

[3] Defendants include directors, underwriters, and investment advisors of designated load mutual funds, an association of mutual funds and affiliated personnel, a number of broker-dealer firms trading in load mutual funds, and the National Association of Securities Dealers. *Complaint, App. to Petitioner's Br.* at 12-17.

defendants have conspired to restrain competition in the trading of mutual fund shares, by vertical[4] and horizontal[5] agreements fixing the prices at which shares will be traded. The District Court ruled that these allegations failed to state a claim upon which relief could be granted, because the price maintenance practices attacked are sanctioned and excluded from the coverage of the antitrust laws by Sections 22(d) and (f) of the Investment Company Act of 1940.[6] These sections, respectively, require dealers to sell investment company shares at the public offering price,[7] and allow open-end funds to restrict the transferability of their securities by statements contained in the registration statement which are not inconsistent with SEC rules and regulations.[8]

In great measure, the disposition of this appeal is governed by the Supreme Court's opinion in *United States* v. *National Association of Securities Dealers.*[9] In that Government action

[4] The vertical agreements involved here were between the funds and their underwriters, and subsequent broker-dealers trading in the shares. They sought to assure that all sales would be made at the fund's public offering price.

[5] The horizontal restraints alleged involved agreements between broker-dealers to trade at the fund's public offering price, and perhaps others.

[6] 15 U.S.C. §§ 80a-22(d) and (f) (1970).

[7] Section 22(d) reads as follows:

> No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

[8] Section 22(f) reads as follows:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

[9] 422 U.S. 694 (1975).

Under the Expediting Act, 15 U.S.C. § 29 (1970), the appeal to the Supreme Court by the Government was taken from the same opinion of Judge Corcoran which is now before us.

which Judge Corcoran heard in conjunction with the private suit now before us, the Supreme Court affirmed the district court's dismissal. That decision by the Court leads us to affirm, with two reservations, the findings and conclusions expressed in the opinion below.

First, while the Supreme Court flatly affirmed the dismissal on the basis of Section 22(f), it reversed the holding that an alternative ground for dismissal exists under Section 22(d). The Section 22(d) requirement that underwriters and dealers sell only at the fund's public offering price could not, said the Court, "be stretched beyond its literal terms to encompass transactions of broker-dealers acting as statutory 'brokers.' "[10] Thus that section was held not to justify immunization of secondary market transactions from the antitrust laws. This reasoning is directly applicable to the private suit before us, and thus, following the Supreme Court, we reverse as to the Section 22(d) grounds for dismissal.

Second, while the Supreme Court's opinion is entirely dispositive of those aspects of the private action relating to intra-fund restraints—that is efforts to assure that all sales of a given fund will be made at the public offering price—it is not entirely clear to us that this is the only type of restraint alleged in the complaint. The Supreme Court's opinion explicitly denied that the Government complaint contained any allegations as to restraints of competition *between* funds,[11] and thus its holding is not dispositive as to any explicitly *inter*-fund combinations which the private parties might assert.

We recognize that a degree of inter-fund restraint is implicit in the intra-fund combinations which the Supreme Court found to be immunized. The fixing of the price at which each fund's shares will trade largely eliminates the price component of inter-fund competition. However, it is also clear that agreements are possible which are explicitly inter-fund in nature, which impair competition arising from factors other

[10] *Id.* at 720.
[11] *Id.* at 733 & n.44.

than price. Fund managers, for example, might agree as to the types of securities each would purchase, and thus position their products in a way to minimize competition between them.

We do not feel able, on the face of the complaint, to determine whether such allegations are implicit in the action before us. However, we find some reason so to suspect, and thus remand to Judge Corcoran for a determination of the matter. In particular, we note one clause of the private complaint which seems to have had no parallel in the Government's action.[12] Petitioners below alleged, combinations to "[p]revent, restrain, lessen and eliminate competition in the trading of the securities of load mutual funds in general and the Fidelity Group Mutual Funds in particular among defendant broker-dealers . . . ."[13] While this might be read solely to allege intra-fund restraint, its language, coupled with the list of defendants, which includes fund managers as well as broker-dealers, might also lead one to a contrary conclusion.

The case is affirmed in part, reversed in part, and REMANDED to District Judge Corcoran for further proceedings not inconsistent with this opinion.

[12] *See Government Complaint, App. to Individual Respondent's Br.* at 1.
[13] *Complaint, App. to Petitioner's Br.* at 25.

IN THE

United States District Court

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 2454-72

GENEVIEVE M. HADDAD,

Plaintiff,

v.

THE CROSBY CORPORATION, *et al.*,

Defendants.

MEMORANDUM AND ORDER

I

The plaintiff, Genevieve M. Haddad, filed this private antitrust action on December 8, 1972. Her complaint, in essence, asserts that the named defendants, including principal underwriters and broker-dealers, together with other unnamed co-conspirators, have combined to restrain competition in the trading of open-end investment company (mutual fund) securities through horizontal and vertical agreements fixing the prices at which shares will be traded. Allegedly such conduct violates Sections 1 through 3 of the Sherman Antitrust Act, 15 U.S.C. §§ 1-3.[1]

In early 1973, shortly after commencement of the present litigation, two related antitrust suits were filed in this Court

[1] The complaint further contends that defendants' failure to disclose these alleged antitrust violations constitutes a separate violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Exchange Act Rule 10b-5, 17 C.F.R § 240.10b-5.

—*United States of America* v. *National Ass'n of Securities Dealers, et al.*, Civil Action No. 338-73 (hereinafter *NASD*), and *Gross, et al.* v. *National Ass'n of Securities Dealers, et al.*, Civil Action No. 426-73 (hereinafter *Gross*).[2]

The *NASD* complaint was filed by the Antitrust Division of the Department of Justice. It charged that the defendants, the National Association of Securities Dealers (NASD), certain mutual funds, mutual fund underwriters, and securities broker-dealers, combined and agreed to restrict the sale and fix the resale prices of mutual fund shares in secondary market transactions between dealers, from an investor to a dealer, and between investors through brokered transactions. Specifically, Count I of the complaint alleged a horizontal conspiracy among NASD members to prevent the growth of a secondary dealer market and brokerage market in the purchase and sale of mutual fund shares, while Counts II-VIII alleged various vertical restrictions on secondary market activities. The United States contended that those agreements, combinations, and conspiracies violated Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1.

The allegations of the complaint in *Gross* substantially corresponded to those made by the United States in the *NASD* case.

Motions to dismiss for failure to state a claim upon which relief could be granted were filed by the defendants in each of the above-mentioned actions. These motions were argued on a consolidated basis and, on December 14, 1973, this Court dismissed the three complaints pursuant to *Fed. R. Civ. P.* 12(b)(6). We held that Sections 22(d) and (f) of the

[2] The complaints in the present case, *NASD*, and *Gross* were followed in turn by approximately fifty private antitrust suits, filed in federal district courts across the country. Those cases were subsequently transferred to this Court by the Judicial Panel on Multidistrict Litigation, and were collectively captioned: In Re Mutual Fund Sales Antitrust Litigation, Civil Action No. Misc. 103-73. All activity in those cases, including discovery, was stayed pending our ruling on several motions to dismiss filed in the *Haddad, NASD,* and *Gross* actions. The stay was later extended until final disposition of any appeals noticed from this Court's ruling on those motions.

Investment Company Act of 1940, 15 U.S.C. §§ 80a-22(d) and (f), when read in conjunction with the Maloney Act, 15 U.S.C. § 78o-3, afforded antitrust immunity for all of the practices challenged, and that apart from such explicit statutory immunity, the pervasive regulatory scheme established by those statutes conferred a limited antitrust immunity in the narrow area of distribution and sale of mutual fund shares. *In Re Mutual Fund Sales Antitrust Litigation*, 374 F. Supp. 95 (D.D.C. 1973).

An appeal from this Court's decision in *NASD* case was lodged in the Supreme Court by the Justice Department, pursuant to the Expediting Act, 15 U.S.C. § 29. Appeals were also taken to the United States Court of Appeals for this circuit by plaintiffs in *Haddad* and *Gross*. The Court of Appeals stayed its proceeding pending resolution by the Supreme Court of the *NASD* appeal.[3]

On June 6, 1975, the Supreme Court affirmed our dismissal of the complaint in *NASD*. *United States* v. *National Ass'n of Securities Dealers*, 422 U.S. 694 (1975). The majority observed that the vertical restrictions attacked by the government in Counts II-VIII of the complaint "are among the kinds of agreements authorized by § 22(f) of the Investment Company Act." 422 U.S., at 728. That being so, the Court held that "the antitrust laws must give way if the regulatory scheme established by the Investment Company Act is to work." 422 U.S., at 729-30. As to the horizontal conspiracy between NASD and its members alleged in Count I,[4] the Court found that "the SEC's

[3] It should be noted that plaintiff Haddad, in support of her request for a stay of appellate proceedings, represented that "the complaint in the Government case . . . made basically the same antitrust allegations as did the Haddad case," and further stated that "the outcome of that case will directly control the result in the instant appeal." Memorandum in Support of Motion to Stay Proceedings, at 1-2.

[4] Count I "originally appeared to be a general attack on the NASD's role in encouraging the restrictions on secondary market activities challenged in the remainder of the Government's complaint," and the conduct alleged in that count "focused in large part on NASD rules, and on information distributed by that association to its members." 422 U.S., at 730. However, the Justice Department retreated to a degree from that position before this Court and the Supreme Court, suggesting that Count I "should be interpreted as a challenge to various unofficial NASD interpretations and to [defendants'] extension of the rules in a manner that inhibits a secondary market." 422 U.S., at 732.

exercise of regulatory authority under [the Investment Company Act of 1940] and the Maloney Act is sufficiently pervasive to confer an implied immunity." 422 U.S., at 730. In so deciding, the Court emphasized:

> It should be noted that *the Government does not contend that appellees' activities have had the purpose or effect of restraining competition among the various funds.*[5] Instead, the Government urges in Count I that *appellees' alleged conspiracy was designed to encourage the suppression of intrafund secondary market activities*, precisely the restriction that the SEC consistently has approved pursuant to § 22(f) for nearly 35 years. 422 U.S., at 733 (footnotes omitted) (emphasis supplied).

The Court found "[t]his close relationship is fatal to the Government's complaint, as the Commission's regulatory approval of the restrictive agreements challenged in Counts II-VIII cannot be reconciled with the Government's attack on the ancillary activities averred in Count I." 422 U.S., at 733-34. Consequently, it held that "[t]o the extent that any of [the defendants'] ancillary activities frustrate the SEC's regulatory objectives it has ample authority to eliminate them." 422 U.S., at 734.[6]

Subsequent to the Supreme Court's decision in *NASD*,[7] the Court of Appeals summarily affirmed our dismissal of the

[5] At the same time, however, the Court observed:

> Indeed, it appears that vigorous interbrand competition exists in the mutual-fund industry—between the load funds themselves, between load and no-load funds, between open- and closed-end companies, and between all of these investment forms and other investments. 422 U.S., at 733, n. 44 (citation omitted).

[6] Of equal significance is the Court's elaboration on the nature of "ancillary activities" which the SEC possesses authority to eliminate:

> The Commission can, for example, require amendment of the NASD rules regulating the conduct of its membership, *see* 15 U.S.C. § 78o-3(k)(3), or *exercise the more general rulemaking power* conferred by § 37(a) of the Investment Company Act, 15 U.S.C. § 80a-37(a), *to contain any of the challenged activities that might in any way frustrate its regulation of the restrictions it authorizes under § 22(f)*. 422 U.S., at 734, n. 46 (emphasis supplied).

[7] After receipt of the Supreme Court's mandate in the *NASD* case, this Court dismissed the fifty multidistrict cases which previously had been stayed. *See* n. 2, *supra*. No Appeals were noticed in any of those actions.

complaint in *Gross*, No. 74-1361, Order, September 29, 1975 (unpublished), and, on April 6, 1976, an opinion was rendered in the *Haddad* appeal. *Haddad* v. *The Crosby Corporation*, 533 F.2d 1247 (D.C. Cir. 1976).

In the *Haddad* opinion, the Court of Appeals concluded that the Supreme Court's decision in *NASD* was "entirely dispositive" of those aspects of the *Haddad* case relating to vertical restraints, that is, "efforts to assure that all sales of a given fund will be made at the public offering price." But, it also found that other types of restraints might be "implicit" in the *Haddad* complaint. 533 F.2d, at 1250. The Court reasoned as follows:

> The Supreme Court's opinion explicitly denied that the Government's complaint contained any allegations as to restraints of competition between funds, and thus its holding is not dispositive as to any explicitly inter-fund combinations which the private parties might assert.
>
> We recognize that a degree of inter-fund restraint is implicit in the intra-fund combinations which the Supreme Court found to be immunized. *The fixing of the price at which each fund's shares will trade largely eliminates the price component of inter-fund competition. However, it is also clear that agreements are possible which are explicitly inter-fund in nature, which impair competition arising from factors other than price.* Fund managers, for example, might agree as to the types of securities each would purchase, and thus position their products in a way to minimize competition between them. 533 F.2d, at 1250 (footnotes omitted) (emphasis supplied).

The Court of Appeals felt unable to determine whether such allegations are in fact implicit in the *Haddad* complaint. However, it found "some reason so to suspect," and noted, with respect to paragraph 42(f) of the complaint in particular, that:

> Petitioners below alleged combinations to "[p]revent, restrain, lessen and eliminate competition in the trading of the securities of load mutual funds in general and the Fidelity Group Mutual Funds in particular among defendant broker-dealers . . . " While this might be read solely to allege intra-fund restraint, its language, coupled with the list of defendants, *which includes fund managers* as well as broker-dealers, might also lead one to a contrary conclusion. 533 F.2d, at 1250 (footnote omitted) (emphasis supplied).

Accordingly, the Court affirmed in part, reversed in part, and remanded the *Haddad* case for further proceedings in the district court to determine whether or not the complaint implicitly alleges "agreements . . . which are explicitly inter-fund in nature, which impair competition from factors other than price."

On remand, this Court requested memoranda illuminating any allegations within the scope of the Court of Appeals' opinion which might be present in the *Haddad* complaint. Extensive briefs were submitted by the parties and oral argument presented thereon.

After careful consideration of the complaint in the present case, the memoranda and oral presentations of the parties, and the decisions in *NASD* and *Haddad*, we conclude that the complaint contains no implicit averments of inter-fund agreements impairing competition arising from non-price factors.

II

Rather than relying upon the language of paragraph 42(f) of the complaint, wherein the Court of Appeals found language which might implicitly allege an antitrust violation, Haddad now maintains that the "gravamen of [her] complaint is to be found at paragraphs 33-40." Plaintiff's Statement, at 3. Plaintiff's characterization of the basic allegations contained in those paragraphs is as follows:

> [T]hey charge suppression of a secondary market in "load" mutual funds. *Such a charge is in essence a charge*

of a horizontal conspiracy among brokers (albeit with the participation of underwriters and fund advisors who were equally beneficiaries of the conspiracy) *since only brokers could effect such a conspiracy. No underwriter and no fund advisor could be a direct party to a suppression of a secondary market* since the parties to the suppressed transaction would be the buying or selling public and its brokers. Nor could a vertical arrangement of a single fund or of all funds survive brokeraged secondary market transactions. *What buyer would pay $269.70 (on a $2,900 transaction) by purchasing in the primary market when he could pay (effectively) $100 in the secondary market?* What seller would choose the primary market when his buyers were in the secondary? What broker would refuse to do business where the customers were? And, finally, what fund advisor would hold to a 9.3% rate when his customer base was eroding? Plaintiff's Statement, at 3 (emphasis supplied).

The conspiracy posited by plaintiff does not appear to be the type which the Court of Appeals suspected might be implicit in her complaint. On the basis of Haddad's own interpretation of the thrust of paragraphs 33-40 and this Court's analysis of the complaint as a whole, it is apparent that the plaintiff does not challenge agreements, explicitly inter-fund in nature, which impair competition among the funds arising from non-price factors. Instead, Haddad alleges a conspiracy "among the brokers" (rather than among the funds), which has the design and direct effect of maintaining the public offering prices which customers must pay to purchase mutual fund shares in the primary market, while absent such restraint, the customer theoretically might pay a lower price in a secondary or brokerage market.[8] Although the plaintiff correctly

[8] The plaintiff principally contests the written agreements which govern relationships between main participants in the primary market distribution of mutual fund shares. Her theory is that these contracts suppress the growth of a secondary market. *See e.g.* Complaint, at ¶ 40.

contends that "[a]ll restraints on competition have consequential impacts on prices,"[9] her arguments are devoid of a single reference to possible anticompetitive purposes or effects of the scheme suggested other than price maintenance.[10]

For the foregoing reasons, this Court is of the opinion that the plaintiff never intended her complaint as an attack on non-price, inter-fund restraints, and that no such allegations are implicit in her complaint.

III

It is, accordingly, by this Court this 30th day of June, 1977,

ORDERED that the complaint herein should be, and the same hereby is, dismissed.

/s/ HOWARD F. CORCORAN

Judge

[9] Plaintiff's Reply Statement, at 2.

[10] Further indication that the present action is premised entirely upon a price-fixing theory is presented in paragraph 44 of Haddad's complaint wherein the allegation of injury to plaintiff and her purported class is limited to the effects of inhibited price competition.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1977
No. 77-1786

Civil 2454-72

GENEVIEVE M. HADDAD, Appellant

v.

THE CROSBY CORPORATION, et al

Appeal from the United States District Court for the District of Columbia.
Before: LEVENTHAL, ROBINSON AND WILKEY, Circuit Judges

JUDGMENT

This cause came on to be heard on the record on appeal from the United States District Court for the District of Columbia, and was argued by counsel. While the issues presented occasion no need for an opinion, they have been accorded full consideration by the Court. *See* Local Rule 13(c).

On consideration of the foregoing. It is ordered and adjudged by this Court that the judgment of the District Court appealed from in this cause is hereby affirmed on the basis of Judge Corcoran's opinion in the District Court.

Per Curiam
For the Court

GEORGE A. FISHER
Clerk

Filed: June 6, 1978.